

# Working Paper Series

**Corporate Governance and The Role of Non-Executive Directors in Large UK Companies: An Empirical Study**

Christopher Pass

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**CORPORATE GOVERNANCE AND THE ROLE  
OF NON-EXECUTIVE DIRECTORS IN LARGE  
UK COMPANIES: AN EMPIRICAL STUDY**

**By Christopher Pass  
Bradford University School of Management**

**ABSTRACT**

In the 1990s various committees (Cadbury, Greenbury, Hempel) reported on governance issues, including the role played by non-executive directors in promoting 'best practice'. Following public concern at cases of 'excessive' pay awards to executive directors and financial irregularities the government has recently appointed the Higgs Committee to review again the contribution of non-executive directors.

This paper presents an empirical study of the involvement of non-executives in large UK companies, assesses the extent to which these companies now 'conform' to the recommendations of 'best practice' proposed by the earlier committees and looks at the general and specific controversies surrounding the employment of non-executives as part of companies corporate governance structures.

## 1. INTRODUCTION

Corporate governance is concerned with the duties and responsibilities of a company's Board of Directors in managing the company and their relationships with the shareholders of the company and other stakeholder groups. Typically full time executive directors have acquired substantial powers in respect of the affairs of the company they are paid to run on behalf of the shareholders. However, executive directors have not always had the best interests of the shareholders in mind when performing their executive duties and this has led to attempts to make directors more accountable for their policies and activities. Non-executive directors have an important role to play in this respect and will be the area of concern in this paper.

A number of reports have been published in the UK in the 1990's prompted by concern at cases of gross mismanagement (for example, the collapse of the BCCI bank and Polly Peck and the misappropriation of employees' pension monies at the Mirror Group) and 'fat cat' pay increases and option/LTIP awards secured by executive directors. The Cadbury Committee Report (1992) recommended a 'Code of Best Practice' relating to the appointment and responsibilities of executive directors, the independence of non-executive directors and tighter internal financial controls and reporting procedures. The Greenbury Committee report (1995) specifically addressed the issue of directors' pay recommending that executive directors' pay packages should be determined by the companies Remuneration Committee consisting solely of non executives and that share awards under executive share option schemes and long-term incentive plans (LTIPs) should be linked to the company's financial performance. The Hempel Committee Report (1998) covered many of the same issues addressed by these two earlier reports recommending ('Principles of Good Governance') checks on the power of any one individual executive director (by, for example, separating the roles of Chairman and Chief Executive), a more independent and stronger voice for non-executives (to check 'empire building' tendencies on the part of executive directors) and more accountability to shareholders at the AGM. In 1998 the 'Code of Best Practice' and 'Principles of Good Governance' were combined and 'the combined code' was formally incorporated into the listing rules of the London Stock Exchange. Despite these initiatives the continuing public outcry at the large payments received by the executives of many companies who have reported lower profits or

losses, combined with recent financial reporting scandals (mainly in the USA it must be said - Enron, Worldcom etc), have served to put the role of non-executives under the 'microscope', so much so that the UK government has recently appointed the 'Higgs Committee' to provide yet another review of the contribution of non-executives to corporate governance matters.

This paper presents an empirical study of the background, experience and duties and responsibilities of the non-executive directors of a sample of large UK companies to illustrate current practice and to indicate to what extent they now conform to the recommendations of the various committees noted above.

## 2. GENERAL ISSUES; CORPORATE GOVERNANCE AND THE ROLE OF NON-EXECUTIVE DIRECTORS

As seen by the Cadbury Committee Report corporate governance is the system by which companies are directed and controlled. Boards of Directors are responsible for the governance of their companies. The shareholders role is to appoint the directors and to satisfy themselves that an appropriate governance structure is in place. Boards of Directors consist of two types of directors - executive and non-executive. The responsibilities of the executive directors include, setting the company's strategic objectives, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardships. Non-executives are appointed on a part-time basis and perform various duties including (in some cases) acting as the company's chairperson and sitting on various key committees: The Nominations Committee, the Remuneration Committee, the Audit Committee. Non-executives are seen as 'guardians' of the corporate good and act as 'buffers' between the executive directors and the company's outside shareholders, i.e. they monitor executive actions and question executive decisions and are required to ensure that the company is acting in a 'responsible' way and in the best interests of the shareholders and other stakeholders.

Why do companies need non-executives? Firstly, legally and commercially they are seen as an important guarantee of integrity and accountability of companies. It is assumed that the interests of those who invest in the company will be safeguarded by the presence of non-executives who can exercise independent judgement. Second, non-executive directors can contribute valuable external business expertise to

the affairs of the company. Non-executive directors can often see risks and opportunities for the company, which might have been overlooked by the company's executives who are typically immersed in the day-to-day running of the business. Third, the role of the non-executive directors can be particularly important when the executive chairman or chief executive of the company is especially entrepreneurial or overbearing by moderating excesses. Fourth, non-executives who are 'well-connected' can offer business opportunities otherwise unavailable. Fifth, some companies require non-executives to see them through a period of corporate transition such as changes in ownership, re-positioning of the business, etc.

However, it must also be recognised that there are potential limitations on the effectiveness of non-executives. First, they are only employed on a part-time basis and are likely to have other work commitments (for example, executive and non-executive directorships in other companies). Thus, they may be unable to devote sufficient time to the company to really understand the needs of the company and what's going on. The phenomenon of multiple directorships has led the National Association of Pension Funds to call for a limitation on the number of non-executive directorships an individual can hold at the same time to no more than five. Second, non-executive directors may lack the expertise to understand (on a part-time basis) highly technical and complex business issues. More particularly they may lack the information (either because it is unavailable or, more, sinisterly, withheld from them) on which to make an informed decision.

On balance most, most commentators and practitioners agree that the 'pros' outweigh the 'cons', although (see later) it is recognised that reforms are necessary. The Cadbury Committee Report 'Code of Best Practice' (as further developed by the Hempel Committee Report,) made the following main recommendations regarding non-executives:

- The Board of Directors should include non-executive directors of sufficient calibre and number "for their views to carry significant weight in the Board's decisions".
  - Non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments and standards of conduct.
  - The majority of non-executives should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their judgement, apart from their fees and shareholdings. Their fees should reflect the time which they commit to the company.
  - Non-executive directors should be appointed for specified terms of office and re-appointment should not be automatic.
  - Non-executive directors should be selected through a formal screening process and both this process and their appointment should be a matter for the Board of Directors as a whole.
  - More generally the Cadbury Committee recommended that the roles of the company Chairperson and Chief Executive should be separated rather than undertaken by one person.
- The Hempel Committee Report made further recommendations:
- Non-executive directors should constitute at least one-third of the total Board of Directors.
  - A company's Nominations Committee, Remuneration Committee and Audit Committee, "should be composed largely of non-executive directors".
  - The appointment of a 'senior' non-executive director who's task it would be to liaise between the executive and non-executive board members.

### 3. EMPIRICAL SURVEY OF NON-EXECUTIVES IN LARGE UK COMPANIES: SOME FACTS AND FIGURES

This section presents an empirical survey of non-executives employed by a sample of 51 large UK companies drawn mainly from the constituent companies of the FTSE-100 listing and selected to represent a broad spread of industrial activities, specifically three companies each from 17 industrial sectors (see Appendix A). The survey covers all those non-executive directors who have served for at least six months of the *current financial year* (extracted from the latest company annual reports - mostly 2001 dates but some for the first quarter 2002). One company Morrison's has no non-executives on its Board of Directors and hence is excluded from the tables listed below. (The company was originally selected for inclusion in the survey with the writer not knowing in advance that this was the case. The reasons why the company does not employ non-

executives are recorded in the next section, and are instructive).

A total of 272 executives and 317 non-executives were employed by the 50 companies in the current financial year. As Table 1 shows in 36 companies (72% of the sample) non-executives comprised one-half or more of total Board membership. The percentage of the Board accounted for by non-executives ranges from 25% (Hays) to 80% (Reckitt Benckiser), with the overall average Board representation of non-executives for the 50 companies being 54%. Companies with a smaller number of non-executives tend to be more limited in their product and geographical focus compared to those companies such as BP-Amoco, HSBC and Vodafone with extensive global coverage.

**TABLE 1 NON-EXECUTIVE DIRECTORS AS A PERCENTAGE OF TOTAL BOARD OF DIRECTORS MEMBERSHIP (EXECUTIVE AND NON-EXECUTIVE)**

%	Number of Companies
25	1
30-39	4
40-49	9
50-59	21
60-69	12
70-79	2
80	1
Overall average (54%)	50

Table 2 indicates the average age of the non-executive directors and the number of companies having women on their Boards. The average age ranged upwards from 51 years (National Express) to 66 years (Barratt). For the survey companies as a whole the average age was 59 years. This is typically higher than for executives (average age around 53 years) and reflects in part the preponderance of retired (i.e. former) executives who have moved from full-time executive responsibilities to part-time duties as non-executives (see Table 6).

**TABLE 2 AGE AND GENDER: AVERAGE AGE OF NON-EXECUTIVE DIRECTORS AND NUMBER OF COMPANIES HAVING WOMEN NON-EXECUTIVES**

Average Age (Years)	Number of Companies
50-54	4
55-59	21
60-64	23
65+	2
Overall Average 59	50

Number of Women Non-Executives	Number of Companies
0	21
1	23
2	5
3	1
Overall Number 36	50

29 of the surveyed companies had female non-executives represented on their Boards. Women constituted one quarter (2 out of 8) of the Board in the cases of Astra Zeneca, BT, Severn Trent and Tate and Lyle; 2 out of 7 in the case of Boots and one third (3 out of 9) for Legal and General. Overall, however, women constituted only 11.4% of Board representation of non-executives, compared to 88.6% for men (see 'glass ceiling' comments in next section).

Table 3 gives details of the length of service of the non-executive directors. The average length of service ranged from 3 years (ICI) to 10.4 years (Balfour Beatty). The overall average length of service for the survey companies is 5.6 years. This is lower than the 'typical' executive Board representation, due in part to the larger number of older non-executives retiring from the Board. Length of service is important insofar as it enables non-executive directors (as 'part-timers') to acquire cumulative knowledge of their company's business.

**TABLE 3 AVERAGE LENGTH OF SERVICE OF NON-EXECUTIVES**

Average Length of Service (years) (Rounded)	Number of Companies
3-4	13
5-6	25
7-8	9
9-10	1
Overall Average 5.6	50

TABLE 4 REMUNERATION OF NON-EXECUTIVE DIRECTORS

Average Remuneration Excluding, Chairperson (£'000)	Number of Companies	Average Remuneration, Chairperson (£'000)	Number of Companies
20-29	14	100-199	17
30-39	22	200-299	10
40-49	9	300-399	3
50-59	2	400+	3
60+	3		
Overall Average £36,800	50	Overall Average £222,000	33

Table 4 provides details of the remuneration of non-executive directors of the survey companies. Excluding chairpersons average fees ranged from £21,000 (Tomkins) to £69,000 (Securicor). Overall, the average remuneration of the non-executive directors, excluding chairpersons was nearly £36,800. This is more than many full-time junior and middle managers earn and for those non-executives holding multiple non-executive directorships, total earnings can be substantial.

In the case of companies having a non-executive chairperson the average non-executive remuneration is considerably boosted (to an overall average of £55,000). Chairpersons, because of the special nature of their duties, are usually handsomely remunerated. 33 of the survey companies were chaired by a non-executive director, with their remuneration ranging from £125,000 (Northern Foods) to £480,000 (Vodafone). Overall, the average remuneration of non-executive director Chairpersons was £222,000. In the main the highest paid non-executives are high profile, internationally renowned former chief executives (for example, Richard Giordano at BG, formerly chair and chief executive of BOC).

Table 5 shows the ownership of ordinary shares by the non-executive directors. Companies typically encourage both executive and non-executive directors to hold ordinary shares in the companies they represent in order to show 'commitment' and as 'inside' shareholders, to align their interests more closely with those of outside shareholders. Average shareholdings ranged from a modest 1,679 shares (Provident) to a massive 2,758,131 shares (Wilson Bowden). Overall, the average number of shares held by the non-executives was 90,126 shares. However, it is to be noted that this figure is unduly 'distorted' by the very high concentration of ownership in three companies (Wilson Bowden, Vodafone and Whitbread). Excluding these companies reduces the average non-executive director shareholding to 28,920

TABLE 5 OWNERSHIP OF ORDINARY SHARES BY NON-EXECUTIVE DIRECTORS

Average owned	Number of Companies
Up to 9,999	21
10,000-19,999	8
20,000-29,999	8
30,000-99,999	8
Over 100,000	5
Overall Average 90,126	50

Table 6 indicates the general background of the 317 non-executive directors of the survey companies. In the main non-executive directors have a very considerable and varied amount of prior experience either as *former* executive directors, or *current* executive directors or from other walks of life such as politics, government offices, academia etc. Thus, they are in a position to offer 'wise counselling'.

TABLE 6 BACKGROUND OF NON-EXECUTIVE DIRECTORS

Background	Number of Non-Executives
Former executives	165
Current executives	124
Other (politics, government depts, academia etc)	28
Total	317

By way of example, Abbey National has seven non-executive directors on their Board: 4 former executives (from companies such as P & G (USA), Deloitte, Haskins and Sells, Woolworths, National and Provident Building Society), 2 current executives (of GSC Partners Europe and Computer Software) and one 'other' (The Dean of City University, London). BAE Systems has seven non-executive directors on their Board: 4 former executives (from such companies as Henkel (Germany), Morgan Stanley Finance), and including

Sir Ronald Hempel formerly of ICI; two current executives (of the Independent Television Committee, Pilkington), plus two 'other' (one a former UK Government minister, the other a Professor of Entrepreneurship at the University of London). Overall of the 317 non-executive directors represented on the boards of the survey companies, 165 are former executives (52% of the sample), 124 are current executives (39% of the sample) and 28 are either former or current politicians, academics etc (9% of the sample companies).

Non-executive directors play a significant role in the corporate governance structures of the companies they serve acting as chairperson and as members of three influential committees in particular, the Nominations Committee, the Remuneration Committee and Audit Committee. In addition they serve on other committees concerned with environmental, safety and ethical issues. These roles involve wide-ranging duties and responsibilities. In brief, chairpersons are required to officiate at main Board meetings of the executive and the Annual General Meeting with shareholders, liaise between the executive and non-executive directors on matters of policy and strategy and generally 'project' the company to the outside world (i.e. P R work); the responsibilities of the Nominations Committee is mainly to seek out, screen and interview potential candidates for executives and non-executive positions, often assisted by outside recruitment agencies; the Remuneration Committee determines the basic salaries and benefits of the executive directors, together with their bonus, option and long-term incentive plan (LTIP) reward schemes, again, often in conjunction with outside consultants; the Audit Committee is concerned with the company's internal financial control systems, with a view to ensuring that 'sound' financial practices are observed. Typically, main board meetings are held monthly and meetings of the other committee's two or three times a year unless urgent matters arise.

Table 7 presents details of the involvement of non-executive directors in the duties indicated above. A non-executive director served as chairperson in 33 of the 50 companies (66% of the sample). All 33 are men. In addition to their duties as chairperson, a large proportion are also members of one or more of the other main sub-committees. It will be noted that the full membership of the Remuneration Committee for all 50 companies consists entirely of non-executive directors. In the case of two companies, one executive served formally as a full member of

the Audit Committee, while in some other cases executives (usually the finance directors) could attend by 'invitation'. As regards the Nominations Committee in a substantial number of companies (64% of the sample) the committee comprised both executive and non-executive directors but in all cases the non-executive directors outnumbered the executive directors. In sum, therefore, non-executives either exclusively (Remuneration Committee) or predominately (Audit and Nominations Committee) 'control' the three key sub-committees.

**TABLE 7 NUMBER OF COMPANIES WHERE A NON-EXECUTIVE DIRECTOR SERVED AS CHAIRPERSON AND WHERE NON-EXECUTIVES CONSTITUTED THE ENTIRE MEMBERSHIP OF THE KEY SUB-COMMITTEES**

Number of Companies	
Chairperson	33
Nominations Committee	18
Remunerations Committee	50
Audit Committee	47
Number of Companies	50

In five companies all of the non-executive directors (including the chair) served on all three sub-committees. More generally, however, companies subscribed to the 'division of labour' principle with the majority of non-executives serving on some but not all of these committees. Looking at the survey companies overall a total of 198 non-executives served on the Nominations Committee (62% of the non-executives total of 317); 217 out of 317 non-executives served on the Remuneration Committee (68% of the total) and 207 non-executives served on the Audit Committee (65% of the total).

Concern has been expressed at the incidence of multiple non-executive directorships. Overall the 317 non-executive directors of the 50 survey companies hold a total of 650 other non-executive directorships, an average of 2 each. The extent to which individual non-executives hold multiple other non-executive positions varies considerably, as Table 8 indicates. Nearly one-quarter of the non-executive directors have no other outside non-executive positions; 19% have one other position, 21% held 2 other positions, 16% held 3 other positions, 10% held 4 other positions, while a further 10% held 5 or more other non-executive directorships. Apart from a small number of exceptions, incidences of multiple non-executive directorships are widely

dispersed across the survey companies rather than highly concentrated in a small number of companies. The exceptions are Hanson where 4 out of their 6 non-executives, Cable and Wireless where 3 out of their 5 non-executives, BA where 3 of their 9 non-executives and WPP where 3 of their 11 non-executive directors, respectively, held 5 or more other non-executive directorships. In terms of *intra-connections* between the survey companies, 52 non-executives (12% of the total) were non-executive directors of two or more of the survey companies.

**TABLE 8 NUMBER OF OTHER  
NON-EXECUTIVE DIRECTORSHIPS**

Number of Other Directorships	Number of Non-Executive Directors
0	77
1	60
2	65
3	52
4	31
5	17
Over 5	15
Total	317

#### 4. DISCUSSION AND COMMENTARY

In this section the general issues surrounding the involvement of non-executives in corporate governance matters are discussed, before looking at the particular concerns and recommendations of the Cadbury and Hempel Committee Reports.

##### (i) General Issues

50 or the 51 companies included in the survey have non-executive directors on their Board of Directors. The exception is Morrison, the food-retailing group. As cited in their Annual Report (2002) the reason for this is: *'The board is made up entirely of executive directors as the board is currently of the opinion that there is no commercial benefit in the appointment of non-executive directors'*. This is a somewhat 'vague' justification it must be admitted. All of the other companies seemingly endorse the positive contribution that non-executives can bring to their companies including:

##### A. Experience and expertise

Non-executives typically have either been former executive directors, or are currently executive directors, or come from a background of politics/government departments, academia, consultancy etc. The survey shows (Table 6) that of the 317 non-executives in the current cohort

52% of them were former executives and a further 39% of them are current executives of a varied mixture of manufacturing and financial service sector companies. To this extent it is argued that they are in a position to offer wise counselling and the benefit of their experience and knowledge of business affairs to the practising full-time executive directors of the company.

##### B. Detachment

Non-executives are not burdened and involved in day-to-day corporate matters as is the case with the executives of the company and can help the executives see the 'big picture' of market and macro-environment factors impinging upon the company. Non executives can bring to bear greater objectivity, look at issues from a broader perspective, question the validity of proposed policies and relate situations to similar events personally encountered elsewhere.

##### C. Contacts

Non-executive directors from backgrounds of government and academia can provide connections to the outside world, which can boost the status of the company and make the company more respectable and solid, hence contributing potential commercial benefits. The survey reveals (Table 6) that 28 non-executive directors are or have been connected to government, academia, consultancy (9% of the total cohort of non-executives).

##### D. 'Checks and Balances'

Non-executives typically act as a 'buffer' between the executive Board and other stakeholders' interests in the company, especially the shareholders. As revealed by Table 7, 68% of the cohort of 317 non-executives served on the Remuneration Committee, 65% on the Audit Committee and 62% on the Nominations Committee (see below section (ii)). They are thus in a strong position to place 'checks' on 'excessive' executive remuneration packages, and the practice of risky and unsound accounting practices.

However, various doubts have been raised about the ability of non-executives to perform their duties to the full (and this has led the UK government to set up another Committee to investigate these matters further). Particular concerns have been raised over the following matters;

##### A. Part-Time Positions

Non-executives perform their duties, particularly those sitting on the Nomination Committee, Remuneration Committee and Audit Committee on an irregular basis, meeting only a few times a

year. As part-timers, it is argued that they are often too 'remote' from internal decision-making processes to make an effective contribution. Lack of information (due to limited time involvement or, at worst 'misinformation' and 'cover ups' by executives - e.g. the recent Enron case in the USA) can be a problem. Others argue that although non-executives contact with the company in any one year is restricted this can be 'counterbalanced' by the non-executives continuing involvement with their companies over a run of years (see Table 3 - 'Length of Service'). Non-executives acquire cumulative knowledge of their companies and the duties they are expected to perform effectively.

### **B. Multiple directorships**

The above concern is compounded it is alleged by the fact that a large number of non-executives have positions with other companies (either as current full-time executive directors- Table 6 or as non-executive directors- Table 8). Although this can help them to bring more experience to their present duties, it could also result in 'distractions' (i.e., too many other outside commitments to devote full attention to any one non-executive position). The survey reveals that 124 of the 317 non-executive directors are currently executive directors of other companies (39% of the total). Overall, the average number of other non-executive directorships held by non-executives of the survey companies is modest (only 2), but it is open to speculation as to what the impact of multiple outside interests are on the effectiveness of non-executives in performing their assigned duties.

### **C. 'Cronyism'**

This leads to another point regarding the potential for 'divided loyalties' (i.e. how 'independent' are the non-executives from the executives?). Cynics note that the recruitment and selection of non-executives is partly dependent on their 'acceptability' by the other directors. This could lead to a situation, they argue, whereby non-executives might 'comply' and endorse policies and pay packages being 'pushed' for by executives.

### **D. Women on Boards**

A final matter concerns the lack of female representation on non-executive Boards. It is argued that this merely mirrors the general lack of females in the director/managerial population as a whole. More cynically, others point to the operation of a 'glass ceiling' whereby male dominated Boards are 'reluctant' to promote women into their fiefdoms. As Table 2 reveals women contributed only 11% of the

total non-executives serving on the Boards of the survey companies.

### **(ii) Some specific issues**

The key factors regarding the contribution of non-executives to 'good principles of corporate governance' have been identified in section 2 and are briefly re-stated below. To what extent have they been acted on by the survey companies?

#### **A. The Status of the Chairperson**

"The role of the chairperson should be separated from that of the chief executive" (Cadbury). Ideally, as others see it, the chairperson should be a non-executive as opposed to being an executive (whether they are the CE or any other executive for that matter), the intention being to avoid one person being 'too all-powerful'. Overall the tendency has been for more and more chairpersons to be non-executive. In the survey currently 33 out of 50 chairpersons are non-executives, and the likelihood is that this figure will increase. In 1995, the number was only 20. However, some companies appear to be reluctant on this matter, for example, Bunzl: "The chairman, Mr Hapgood continues to act in the capacity of Chief Executive. The Board recognises the concern, expressed in a general context, about the possible negative effects of a concentration of power through a combined chairman and CE role, but believes these do not presently apply to the company for a variety of reasons. The board has a majority of non-executive directors; the group's operations are devolved and the group benefits from the presence of strong senior line management in those operations; and the Deputy Chairman and senior independent non-executive director, Mr Dyer is a former non-executive chairman of the group" (Bunzl, Annual Report 2001).

Of the 17 companies where the chairperson and CE are executive, in 11 cases the two roles are undertaken separately, thus indicating, overall (44 companies) there is a high conformance to the Cadbury recommendation in splitting Chairman and Chief Executive as best practice.

#### **B. Independence of non-executives**

Both the Cadbury and Hempel Committee Reports, recommended that non-executive directors should be 'independent' of the Board to ensure objectivity. Any non-executive director who is, for example, a retired ex-director or who works for a firm that provides services to the company, may be perceived as being less than wholly independent (Weir and Laing 2001). In addition, non-executive directors with many years

of experience on the same Board may become less effective monitors as they build up close relationships with the executive directors (O'Sullivan and Wong, 1999). This supports Cadbury's claim that non-executive director independence may diminish as board tenure increases. Hempel also made a point in this regard saying "there is a risk of non-executive directors becoming less efficient and objective with length of service and advancing age, and the Board should be vigilant against this". The survey reveals that the average length of service of non-executive directors overall is 5.6 years (Table 3). However, there is no reliable evidence to positively substantiate the points raised above. On the contrary, as noted earlier long-term involvement with their companies may, by improving their knowledge and understanding of the company's affairs add to their effectiveness. Another factor which may affect non-executive directors independency is their pay particularly if it involves not just annual fees but their participation in long-term incentive schemes (such as options) which are typically granted to the companies executive directors (Pass, Robinson and Ward, 2000). Again this consideration may cloud their objectivity. Cadbury stated "we regard it as good practice for non-executive directors not to participate in share option schemes". With the exception of only a few retired executives who now occupy positions as non-executives in their companies and who have 'carried over' options previously granted to them as executives, the survey reveals that none of the other non-executive directors hold options or LTIP grants.

### **C. Senior Non-Executive**

"A senior non-executive should be nominated to present the views of the other non-executives in dealing with the executive Board; this person should be separate from the chairperson" (Hempel). This recommendation has been acted upon by all of the 50 companies.

### **D. Non-executive directors representation on the Board of Directors: The issue of Board 'Balance'**

According to the Cadbury Committee report non-executive directors should have "sufficient' representation as to carry weight" at Board meetings. More specifically the Hempel Committee Report recommended that non-executive directors should make up at least one-third of the main Board. The survey shows (Table 1) that non-executive directors make up over one half of the main Board (54% of the total survey companies). Only Hays (with only 25% of non-

executives on the Board) falls below the recommended minimum limit, while in other cases, non-executives have a very substantial presence (eg BA - 75%, BG - 75% Reckitt Benckiser - 80%). In short the survey indicates that larger companies in the UK have been doing far better than that which the Cadbury and Hempel committees recommended with regard to non-executive director representation on the Board of Directors.

### **E. Sub-Committee representation**

The Cadbury/Hempel Reports recommended that the establishment of various sub-committees including the Nomination Committee, Remuneration Committee and Audit Committee, with membership confined largely to non-executives. All 50 of the survey companies now operate such Committees (Table 7). The Remuneration Committee of these companies are currently made up entirely of non-executives, and with the exception of 3 companies, the Audit Committee likewise is made up exclusively of non-executives. The exception is the Nomination Committee which has in most cases an executive presence, but with typically non-executives accounting for more than 80% of the membership. Therefore, the survey indicates that there is a good conformance to the best practice recommended by Cadbury and Hempel with respect to non-executive directors' representation on sub-committees. (see also Bostock, 1995).

## **5. CONCLUDING COMMENTS: THE FUTURE ROLE OF NON-EXECUTIVE DIRECTORS**

Overall significant progress has been made in meeting in numerical (ie quantitative) terms the recommendations of the Cadbury and Hempel Committee Reports. However, doubts and concerns have been raised as to the effectiveness (ie in qualitative) terms of non-executive representation. The 'failure' of non-executives, it is alleged, to curb excessive 'fat cat' payouts to executive directors in the UK and USA and to detect auditing frauds (eg Enron, Worldcom in the US) has increasingly brought their role into the spotlight.

Commentators on corporate governance issues as it relates to the role of non-executive directors fall into two camps- one favouring a down-grading of their role or even abolishment, the other suggesting various ways in which their effectiveness could be improved upon. It was noted earlier the reason why one of the companies selected for the survey does not employ non-executive directors. Morrisons, the food retailing company, maintains that there is

"no commercial justification" for their involvement in the company. Recently Lord Young (President of the Institute of Directors) advocated their abolishment. His view is that relying on part-time outsiders to keep Boardrooms in check was 'naïve': "The idea has come about that in some manner non-executives can second guess the executives. Of course they can't. "If management is not too forthcoming, they can never even know, until it is far too late". (Institute of Directors' Annual Convention April 2002). His 'solution' is to make the executive directors themselves directly accountable for their actions by law. Thus, it would be a criminal offence (punishable by imprisonment) for executive directors to falsify the company's accounts or mislead their outside auditors. Likewise he advocates that companies should not rely on remuneration committees comprising non-executives to decide director's pay but that instead it should be a criminal offence not to disclose all details to shareholders who would be consulted and required to vote on the proposed pay packages.

This however is not the collective view of the Institute of Directors membership and clearly the abolition thesis is not supported by the companies in the survey who intend to continue using the services of non-executives. The government too is following this line but recognising that there are 'faults' in the system which need to be scrutinised and tightened-up in order to improve the effectiveness of the work of the non-executive directors. The government has recently appointed Derek Higgs to review this matter. The remit of the Higgs Committee is to assess the role of non-executive directors, looking at how they are appointed and where are they drawn from. The review will be wide-ranging covering independence, effectiveness, accountability, remuneration issues and non-executive directors relationships with the shareholders, particularly institutional investors. Without pre-judging the outcome of the Higgs Committee, recommendations advanced by other commentators to date include:

1. Increasing the time non-executives devote to the company's affairs. More regular committee meetings, for example, would help increase their understanding and involvement.
2. Limiting the number of non-executive directorships simultaneously held by an individual. (The National Association of Pension Funds recommends a 'ceiling' of five). This would help focus the attention and

energies of non-executives in a more clearly defined way.

3. Increasing the level of non-executive remuneration. Some non-executives are already well paid for the limited amount of work they undertake. (The average fees of non-executives in our survey was £37,000). Others, however argue that higher rates would provide a powerful inducement "to do a decent job".
4. Providing more access to company information. Non-executives should be encouraged and facilitated in their efforts to obtain more information about what's going on in the company. Greater interaction between executives and non-executives on key areas of the business must be improved upon.
5. Widening the non-executive 'pool'. A big criticism of the way non-executives are currently recruited is that basically it is by recourse to the 'old boy network', resulting in a self-perpetuating oligarchy of the 'chosen few' circulating around the Boards of major companies. Recruiting non-executives from a broader community appears attractive but there are practical problems in doing this, and also a question mark over their fitness for the task.

Some observers and companies (for example, Unilever) advocate a two-tier Board structure as in Continental Europe- an Executive Board and a Supervisory Board, the latter consisting of non-executives as well as other stakeholders such as employees. This goes against the grain of the traditional UK system of a unitary Board which embraces the philosophy of 'collective' responsibility'. In itself such a move would not resolve the fundamental problems inherent in using non-executives - ie there are limits to what they can achieve as part-timers. Perhaps the best way forward is to 'tighten-up' on the involvement of non-executives while at the same time imposing even stronger penalties on executives for malpractice (eg false accounting) and give investors more opportunity to express their views (eg require the Report of Remuneration Committee to be voted on at the Company's AGM *separately* from the main Annual Report).

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## APPENDIX A – SURVEY COMPANIES

Company	Industry Sector
Abbey National, Barclays, HSBC	Banks
Allied Domecq, Scottish & Newcastle, Whitbread	Beverages
Hanson, Wolseley, RMC	Building Materials
BP-Amoco, ICI, BOC	Chemical/Oil
Balfour Beatty, Barratt, Wilson Bowden	Construction
BG, Scottish & Southern, Severn Trent	Energy
BAE Systems, GKN, Tomkins	Engineering
Cadbury Schweppes, Tate & Lyle, Northern Foods	Food Processors
Morrison, Tesco, Sainsbury	Food Retailers
Next, Dixons, Boots	General Retailers
Amersham, AstraZeneca, Reckitt Benckiser	Health & Pharmaceuticals
Prudential, Legal & General, Provident Financial	Insurance/Other Financial
Hilton, Six Continents, Rank	Leisure
WPP, Pearson, Reuters	Media
Bunzl, Securicor, Hays	Support Services
BT, Cable & Wireless, Vodaphone	Telecoms
BAA, BA, National Express	Transport

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